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No. 221

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1951

C. E. KING AND JUANITA M. KING, *Petitioners*
v.
COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT AND SUPPORTING BRIEF.

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v.
COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

May It Please the Court:

Petitioners, C. E. King and Juanita M. King, respectfully pray for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit at New Orleans, Louisiana, to hear this cause and to review the decision of the Court of Appeals in affirming the judgments of The Tax Court of the United States. Petitioners respectfully show to this Honorable Court:

1.

Summary Statement of the Matter Involved.

There is no dispute as to the facts and no conflicting evidence, petitioner C. E. King being the only witness on the sole issue in this case. The only ques-

tion involves the legal conclusions reached by the Tax Court, and approved by the Court of Appeals for the Fifth Circuit, in construing a clause in Section 117 (j) of the Internal Revenue Code and applying it to this case. As will more clearly appear hereafter, the decision in this case is in direct conflict with the decision of the Seventh Circuit Court of Appeals in *Three States Lumber Company v. Commissioner,* 158 F.2d 61.

Petitioners at all times material were husband and wife and all their property and income were community property. Each brought identical cases before the Tax Court, which were consolidated by order of that court (R. 4, 57), although separate decisions were entered in each case. (R. 35, 36). The Court of Appeals ordered them consolidated for all purposes. (R. 90.) They were tried before the Tax Court on the pleadings (R. 5-29) and evidence introduced at the hearing. (R. 57-89).

The question was whether certain houses at Texas City, Texas, that petitioners were renting to tenants were, when sold in 1946,

> "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" (Sec. 117(j) I. R. C.)

as contended by the respondent with the profit on the sale taxable as ordinary income, or were not so held, as contended by petitioners, with the profit taxable at the capital gains rate. The Tax Court held against petitioners (R. 29-36) and the Court of Appeals affirmed (R. 97-100).

The case involved the profit on the sale in 1946 by petitioners of 49 houses which they were renting to tenants and had owned for more than six months. The renting of the houses was a trade or business under Section 117(j) of the Internal Revenue Code so that they were real estate used in a trade or business under that section and the profit was taxable at the capital gains rate, (*Leland Hazard v. Commissioner of Internal Revenue,* 7 T. C. 372), unless they came within the exclusion set forth in that section of

> "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

The interpretation and application of this clause is the only question involved in this case.

As the Court of Appeals and this Court may reverse the decision of the Tax Court only if its holding is clearly erroneous, we will set forth the facts in as strong a manner against the petitioners as even the respondent could do. The findings of the Tax Court are at R. 29-35.

Petitioner King has never had a real estate broker's license (R. 28, 32), and showed in his income tax returns introduced by respondent for 1945, 1946 and 1947 (Respondent's Exhibits C, D and E) that his chief business was the operator of rental property. He never subdivided property or sold lots at retail although he at times owned minority stock interests in two or three corporations so engaged (R. 32), but did own extensive rental properties. (R. 69-71, and Petitioners' Exhibit No. 11). His income tax returns

for 1945, 1946 and 1947, above referred to, showed that his only sales of real estate were: in 1945, 2 of the Texas City houses; in 1946, 49 of these houses and a 200-acre farm; and in 1947, 49 of these houses and a 320 acre farm he had bought in 1942.

The following is a history of the houses as set out in the findings of the Tax Court. At the start of and during World War II, a great many war industries which needed workers were located at Texas City. The Federal Housing Authority (F. H. A.) urged builders to construct houses for rent to workers, and explained how they could be financed under Title VI of the National Housing Act. A corporation would build the houses and borrow the money up to 90% of the value with F. H. A. guaranteeing the loan. The J. L. Martin Investment Company acquired two tracts of land at Texas City upon which it built 50 and 270 houses, respectively, under this plan. It had to get priorities for the materials from the War Production Board, but to get the priorities it had to agree that the houses would be held for rental and *not* for sale, to which the Company agreed. No houses could be sold without the permission of F. H. A. In the latter part of 1942 after all arrangements had been made with F. H. A. petitioner King bought 50% of the stock of the Company and became its President, and the Company built the 320 houses and all were rented to workers.

In the early days 22 houses were rented with an option to buy. When petitioner became President,

he gave notice to those tenants to exercise their options, and when none did, he cancelled the options. (R. 77, Respondent's Ex. H, R. 76, 32). The company did sell 6 houses in 1944 and 22 houses in 1945. (R. 32, 33).

When the war ended in Europe in early 1945, *F. H. A. brought pressure on the company and similar companies to sell* houses to reduce its liability on the loan guaranties. (R. 33, 80, 82, 83). All the tenants were then canvassed as to the possibility of sales to them. (R. 33.)

On account of war shortages the houses were built of cheap construction and the Company was losing money.

In July, 1945, petitioners bought the remaining 50% of the stock of the Company, and in August, 1945, the Company was dissolved and title to the houses vested in petitioners. They sold 2 houses in 1945 and the presently involved 49 in 1946. No real estate brokers or salesmen were employed, but a commission was paid to the manager of the rental project on sales made by him and some small ads were run in newspapers (R. 33, 69).

As shown by Petitioners' Exhibit No. 10, all of these houses sold in 1946 were rented varying from 23 to 46 months.

On the basis of such a record, even though it was undisputed that petitioners were never in any manner engaged in buying and selling real estate or houses, the Tax Court held that these houses were

held by petitioners primarily for sale to customers in the ordinary course of their trade or business (R. 34, 35), and entered judgments against petitioners (R. 35, 36). The Court of Appeals affirmed (R. 100).

It is submitted that the legal conclusion reached by the Tax Court finds no support whatever in the undisputed facts, and the Court of Appeals should have set it aside as clearly erroneous. By failing to do so, it has created an irreconcilable conflict with the decision of the Seventh Court of Appeals in *Three States Lumber Company v. Commissioner,* 158 F.2d 61, where, in a case that cannot be distinguished from this one on the essential facts, that court construed and applied the same provision of the Internal Revenue Code in a directly opposite manner and reversed the Tax Court. As will become more strikingly apparent when this case is analyzed, this action of the lower court will be controlling in a wide range of other transactions and cases. Its consequences go far beyond this particular case and these particular taxpayers. This action by the courts below is directly contrary to the plain meaning of the applicable law, both under the clear terms of the statute itself and in the light of its Congressional history.

2.

Statement Disclosing Basis Upon Which It Is Contended This Court Has Jurisdiction.

Jurisdiction of this cause is conferred upon this Honorable Court by United States Code, Title 28, Section 1254.

The judgment of the Court of Appeals was entered on May 22, 1951 (R. 100) and petitioners' Petition for Rehearing was denied on June 29, 1951 (R. 114).

3.

Question Presented

There is only one question presented. A taxpayer owns a certain amount of properties. He is not and never has been in the *trade or business* of selling such properties or indeed any properties. He decides to sell part of them. The profit from their sale is taxable at the capital gains rates under Section 117 (a) or (j) of the Internal Revenue Code, *unless* his action in selling them, *and that action alone,* causes them to cease to be capital assets and become

> "property held by the taxpayer for sale to customers in the *ordinary course* of his trade or business."

On undisputed evidence the Tax Court held here that such action alone caused them to become such *new* kind of property, and the Court of Appeals for the Fifth Circuit affirmed. The only question is whether this is the proper construction of the above mentioned clause. The decision of the lower court is in direct conflict with that of the Seventh Circuit Court of Appeals in *Three States Lumber Company v. Commissioner,* 158 F.2d 61, in which that court reversed the Tax Court (4 T. C. M. 955), and held directly contrary to the court below in this case.

4.

Reasons Relied on for the Allowance of the Writ.

The reasons relied on for the allowance of the writ

are because the Court of Appeals has decided an important question of Federal law which has not been and should be settled by this Court; because this question has been decided in a way *directly in conflict* with the decision of the Seventh Circuit Court of Appeals in *Three States Lumber Company v. Commissioner of Internal Revenue,* 158 F.2d 61, and in a way that drastically distorts the plain meaning of the clause under consideration in Section 117 (j) of the Internal Revenue Code, particularly as emphasized by the legislative history of that clause, and because this erroneous interpretation and application of that important clause will be controlling in a wide range of other transactions, extending far beyond this particular case.

(1) As petitioners were renting these houses, they were in the trade or business of renting them, *which is not the trade or business of selling houses* (*Leland Hazard v. Commissioner of Internal Revenue,* 7 T. C. 372). Thus they came directly within Section 117 (j) of the Internal Revenue Code taxing at the capital gains rates profits on sales of property used in a trade or business of a character subject to a depreciation allowance (houses) and real estate used in a trade or business, held for more than 6 months, unless, *solely as a result of petitioners' efforts in selling them,* they became

> "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

The Tax Court, although finding they had been built

for rental purposes and were being rented, held that the fact that petitioners made the efforts necessary to sell them caused them to become property held primarily for sale to cusomers in the ordinary course of peitioners' trade or business. This same identical clause occurs in Section 117 (a) which in defining capital assets similarly excludes property held for sale in the *"ordinary course"* of a trade or business from the term "capital assets." This holding that merely the effort necessary to sell a capital asset causes it to cease to be a capital asset is contrary to the taxing laws and all other decisions thereunder. (See *Elgin Building Corporation v. Commissioner,* 8 T. C. M. 114, *Farry v. Commissioner,* 13 T. C. 8, involving war built houses similar to these).

(2) The holding is in direct conflict with that of the Seventh Circuit Court of Appeals in *Three States Lumber Company v. Commissioner,* 158 F.2d 61, as we pointed out to the court below in our petition for rehearing. (R. 101-113). In that case a lumber company owned over 17,000 acres from which it had cut the timber. Ceasing lumbering operations in 1922, it was actively and continuously engaged from 1922 through 1935 in selling its lands. The court in that case held it was by such sales not engaged in a trade or business and the lands remained capital assets *and reversed the Tax Court.* The holdings in these two cases can not be reconciled.

(3) The effect of this holding is that, if an owner of property is not engaged at all in buying and selling any properties, but decides to sell some that require

any sales effort, he automatically becomes engaged in the trade or business of selling properties and they cease to be capital assets. The obvious error of such an interpretation of this clause may be readily illustrated. A man not engaged in buying and selling stocks owns stocks in fifty companies, twenty-five listed on the New York Exchange and twenty-five unlisted. He decides to sell his stock in ten companies of each class. By a simple telephone call to his broker he sells those that are listed. Even the Government would not deny those the classification of capital assets. As to the unlisted stocks a great deal of effort is required to sell them. Under the holding of this case he has thereby gone into a trade or business and those unlisted stocks lose their classification of capital assets.

(4) As is obvious from (3) above, the holding of the court in this case extends far beyond this particular case. It applies not only to houses but to all kinds of other properties under both Section 117 (a) and 117 (j), and will be controlling in all kinds of transaction involving the sale of assets. As the holding of the court below is so clearly wrong and will be of such widespread effect, it should be corrected by this Court.

(5) As will more fully appear from our brief, this clause excluding property from capital assets prior to the Revenue Act of 1934 read

> "property held by the taxpayer primarily for sale in the course of his trade or business."

This was intentionally changed in the Revenue Act of 1934 to read

> "property held by the taxpayer primarily for sale *to customers* in the *ordinary* course of his trade or business."

This change restricted the exclusion and thereby *narrowed* the class of property *excluded* from capital assets, and emphasized the meaning of this clause as grasped by the Seventh Circuit Court of Appeals in the *Three States Lumber Company* case, supra, but not recognized by the court below.

(6) This clearly erroneous ruling runs exactly counter to the position taken by the Government in 1934 in changing this clause to read as set forth in (5) above. In that year it was dealing with losses and changed the wording of this clause so as to restrict this exclusion from capital assets and thereby cause losses to become capital losses which could be deducted only against capital gains. While it is true in this case there was a profit on the sale of the houses, if there had been losses, then according to the Government's contentions in this case these losses would have been deductible against ordinary income. This construction of this clause by the court below will be equally applicable to losses on the sale of capital assets embraced in Section 117(a), and in such case the Government will be right back where they were before the 1934 change.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari may issue out of and under the

seal of this Honorable Court directed to the United States Court of Appeals for the Fifth Circuit commanding said court to certify and send to this Court on a day certain, to be therein designated, a full and complete transcript of the record of all the proceedings in the Court of Appeals in said cause entitled *C. E. King and Juanita M. King, Petitioners, v. Commissioner of Internal Revenue, Respondent,* No. 13,401 on its docket, to the end that said cause may be reviewed and determined by this Court as provided by United States Code, Title 28, Section 1254, and that your petitioners may have such other and further relief or remedy in the premises as this Court may deem appropriate and in conformity with the laws of the United States, and that on hearing before this Honorable Court the judgments of the Court of Appeals and of The Tax Court of the United States be reversed.

C. E. KING AND JUANITA M. KING

By HOMER L. BRUCE
Attorney for Petitioners

No.....

In the SUPREME COURT OF THE UNITED STATES
October Term, 1951

C. E. KING AND JUANITA M. KING, *Petitioners*
v.
COMMISSIONER OF INTERNAL REVENUE, *Respondent*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

The Opinions of the Courts Below.

The opinion of the Tax Court is found at page 29 of the record and is reported in 9 T. C. M. 136. The opinion of the Court of Appeals is found at page 97 of the record and is reported in 189 F.2d 122.

II.

Jurisdiction.

Stated under heading 2 of the petition.

III.

Statement of the Case.

A full statement of the case has been given under

heading 3 of the petition and in the interest of brevity is not repeated.

IV.

Applicable Statutes.

Internal Revenue Code:

SEC. 117 (as amended by Section 115 (b) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Section 151 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798). CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.* — The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

(j) (as added by Section 151(b) of the Revenue

Act of 1942 and Section 127(b) of the Revenue Act of 1943, c. 63, 58 Stat. 21). *Gains and Losses from Involuntary Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held

for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

(26 U.S.C. 1946 ed. Sec. 117).

SEC. 1141. COURTS OF REVIEW.

(a) *Jurisdiction.*—The courts of appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in Section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in Section 1254 of Title 28 of the United States Code.

(c) *Powers.*—

(1) *To affirm, modify, or reverse.*—Upon such review, such courts shall have power to affirm or, if the decision of the Board is not

in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing as justice may require.

(26 U.S.C. Sec. 1141.)

V.

Specification of Errors.

The Court of Appeals erred in affirming the holding of the Tax Court that, when the houses involved in this case were sold by petitioners, they were property held by petitioners primarily for sale to customers in the ordinary course of their trade or business, as such holding was clearly erroneous and contrary to law.

ARGUMENT.

Summary of the Argument.

Point A.

As petitioners were not engaged in the trade or business of buying or selling houses and as the houses here involved were the only real estate sold by petitioners except a farm in each of 1946 and 1947, petitioners in liquidating their investment in these houses were not thereby engaged in a trade or business in the *ordinary* course of which they were holding these houses for sale to customers.

Point B.

If the holding of the Court of Appeals in this case is allowed to stand, then the general rule throughout the Fifth Circuit will be that, if a taxpayer, not otherwise engaged in the trade of buying and selling,

should decide to sell a group of capital assets, they by that mental decision of the owner and his necessary efforts to carry it out cease to be capital assets and become property held primarily for sale to customers in the *ordinary* course of a trade or business. This is not the rule in any other circuit.

Points A and B.

The decision in this case is not a narrow one applicable only to the specific facts involved, but the court has so interpreted and applied this clause of Section 117 (j) of the Internal Revenue Code as to make it applicable not only to other cases dealing with the sale of houses built under the war program but also to a wide variety of transactions continually arising where people desire to convert various kinds of properties into cash. The holding by the lower courts that, where a considerable amount of capital assets are being liquidated, the owner by such liquidation thereby becomes engaged in the trade or business of selling property and thereby causes the property to be held primarily for sale to customers in the *ordinary course* of such business, is of wide and general importance.

A brief review of the history of this clause in the Revenue Acts is very revealing. The specific clause involved is one excluding from the term "capital assets"

> "property held by the taxpayer primarily for sale *to customers* in the *ordinary* course of his trade or business."

This same clause occurs in Section 117(a)(1) and (j)(1). Section 117 (a) (1) defines capital assets as any property, whether or not connected with a trade or business, but excludes, together with other classes of property not here material, property held primarily for sale to customers in the ordinary course of a trade or business, and real or depreciable property used in a trade or business.

Section 117 (j) (1) then deals with real or depreciable property used in a trade or business. It provides that gains from the sale of such property held for more than six months shall be taxed as long term capital gains, and that losses therefrom in excess of such gains shall be deductible as ordinary losses. In defining such property, however, it excludes therefrom, as does Section 117 (a) (1), property held primarily for sale to customers in the ordinary course of a trade or business. In this case there were no losses involved and the question is whether petitioners' gains were taxable at the capital gains rate.

Substantially the same provisions as Section 117 (a) (1) in reference to capital assets have been in the Revenue Acts for many years while Section 117(j) was first enacted by the Revenue Act of 1942. However, the excluding clause involved herein has a definite and significant Congressional history. It must be borne in mind that this clause is one used for the purpose of excluding the property defined from the term "capital assets." The first time this clause occurred was in Section 208(a)(8) of the Revenue

Act of 1924 (43 Stat. 253, 262-263, which provided that capital assets would not include

> "property held by the taxpayer primarily for sale in the course of his trade or business."

This identical language continued in the Revenue Acts of 1926, 1928 and 1932 and was not changed until Section 117(b) of the Revenue Act of 1934 (48 Stat. 680, 714), which changed the words to read as follows, the words inserted being shown in italics:

> "property held by the taxpayer primarily for sale *to customers* in the *ordinary* course of his trade or business."

This Court will judicially know that 1934 was during the depression and that people were suffering in general losses when they sold property that had been bought back in the earlier years before the depression. The entire purpose of this change was to increase the category of capital assets so as to make the losses capital losses with the restrictions on their deductibility, instead of ordinary losses deductible against ordinary income. This is most forcefully pointed out by the Tax Court in *Thomas E. Wood v. Commissioner of Internal Revenue,* 16 T. C. —, No. 28, Commerce Clearing House Decision 18070, in which the Court said in part:

> "In 1934 Congress amended section 117 for the purpose of treating certain transactions in securities as transactions in capital assets in order that losses incurred in these transactions could not be deducted in full. Congress was prompted to this action by the disclosure that several prom-

inent financial leaders had paid no Federal income tax during 1930, 1931 and 1932, because their losses on sales of securities offset their very substantial income from other sources. (Miller, The 'Capital Asset' Concept, 59 Yale L. J. 837 (1950). Latham, Taxation of Capital Gains, 23 Cal. L. Rev. 30, 34 n. 13 (1935)). This disclosure had resulted in the insertion of a provision in the National Industrial Recovery Act, restricting the deduction of losses upon sales of securities when incurred by 'traders or other taxpayers who buy and sell securities for investment or speculation, whether or not on their own account, and irrespective of whether such buying and selling constitutes carrying on of a trade or business.' In the Revenue Act of 1934 Congress sought to accomplish this same result by amending the definition of 'capital assets' in the new section 117 so as to exclude, not *all* property held primarily for sale in the course of business, but only such property as was held primarily for sale 'to customers' in the 'ordinary' course of business."

See report of the Senate Finance Committee on the Revenue Act of 1934, 1939-1 (Part 2) Committee Reports, Cumulative Bulletin, pages 255, 281 and 595; and Conference Report, page 632. A typical case under the prior law was *Ignaz Schwinn v. Commissioner of Internal Revenue,* 9 B. T. A. 1304 (1928). That taxpayer devoted all of his time to buying and selling stocks and commodities. In 1924 he sold at a loss some stock that he had purchased in 1919. The Commissioner of Internal Revenue contended this was a capital asset and the loss was a capital loss, but the court held that it was not a capital asset as the taxpayer was in the trade or business of buying and

selling stocks and this stock was held primarily for sale in the course of that trade or business and was therefore excluded by the clause as then existing from the term "capital assets." In order to strike at this situation in a period when losses were prevalent Congress in 1934 by the change shown provided that property to be excluded from capital assets must be held not only primarily for sale but primarily for sale *to customers* and in the *ordinary course* of a trade or business.

How could the law be clearer that, for property to be excluded from capital assets it must not only be held primarily for sale but primarily for sale in the *ordinary course* of a trade or business? This obvious meaning, so strongly emphasized by Congress in its express amendment of the law in 1934, was entirely overlooked by the Tax Court in its findings on this particular point as shown in the first paragraph of the court's opinion (R. 34) where it found that the properties involved were held primarily for sale to customers but did not find they were held for sale to customers *in the ordinary course of a trade or business.* We quote the following first paragraph of the opinion of the Tax Court:

> "There is no doubt in our minds that the houses in question were originally built primarily for rental purposes. This fact, however, is not an end of the matter. The basic question thus becomes,—did the corporation, of which petitioner was president, or the petitioner as an individual, after acquiring the properties in 1945, depart from the original purpose and hold the properties primarily for sale to customers?"

This is not a sufficient finding of fact to justify the legal conclusion set out in the last paragraph of the opinion of the Tax Court where it simply quotes this clause as describing the character of this property held by the taxpayer.

It will be borne in mind that under Section 117 (a)(1) houses that are subject to depreciation allowance and real estate used in a trade or business are excluded from capital assets. However, if houses and real estate are held for more than six months and are used in a trade or business, then under Section 117(j) gains from their sale are taxed at the capital gains rates. A man may be actively engaged in the general real estate business of buying and selling properties, and at the same time as to certain properties be engaged in the entirely distinct trade or business of renting them. Where property is rented, it is consistently held that such property is used in a trade or business, and when sold, the profit is taxable at the capital gains rate under Section 117(j). *Leland Hazard v. Commissioner,* 7 T. C. 372; *Nelson A. Farry v. Commissioner,* 13 T.C. 8; *Elgin Building Corporation v. Commissioner,* 8 T.C.M. 114; *Delsing v. United States,* 186 F.2d 59. Even though a partnership is actively engaged in cutting timber and selling the finished lumber, its sales of standing timber are treated as sales of capital assets and not of property held for sale in the ordinary course of its trade or business, *Carroll v. Commissioner of Internal Revenue,* 70 F.2d 806; and the repeated sale of timber lands by

owners thereof is still treated as the sale of a capital asset, *United States v. Robinson,* 129 F.2d 297.

As heretofore stated, and as pointed out to the Court of Appeals in our petition for rehearing (R. 101-113), the holding in this case is directly in conflict with that of the Seventh Circuit Court of Appeals in *Three States Lumber Company v. Commissioner,* 158 F.2d 61. We discussed the application of that case to this one in detail on pages 6 to 11 of our petition for rehearing. In the *Three States Lumber Company* case the Tax Court had held that the properties sold were properties held primarily for sale to customers in the ordinary course of the Company's trade or business and therefore the gain was ordinary income. The Seventh Circuit Court of Appeals held that there was *no rational basis* for such a conclusion and reversed the judgment of the Tax Court. In that case the lumber company had operated a sawmill and had purchased about 17,000 acres of timber lands. By 1922 it had cut the timber and it then abandoned its operations, disposed of its mill and began the sale of the 17,000 acres. Its sales continued from 1922 through 1935. It employed a man to take charge of the sale of the land and he gave from half to all of his time to that work. It employed others to assist him, advertised the lands in local papers and farm journals and by posters on the land. It held the land out for sale to any purchasers in any amounts consisting of ten acres or more. The Circuit Court of Appeals in reversing the Tax Court said in part at 158 F.2d 64:

"We think there is no rational basis for this conclusion in the facts presented. It is perfectly obvious that petitioner had bought the land for the primary purpose of producing lumber and that, having exhausted the timber, it no longer had any use for it and desired to dispose of it. Petitioner let it be known that the lands were for sale and kept one man, a stenographer and a helper in its office for the purpose of contacting prospective purchasers and completing sales and if, when sales were completed, any questions as to the proper boundary lines arose, had surveys made in order to establish those lines. The land was wet and covered with stumps and underbrush. The liquidation progressed slowly not only because of the physical condition of the land and lack of demand for such property but also because of difficulties encountered in the nation-wide depression. *These facts are consistent only with a desire and attempt to get rid of capital assets which no longer furnished income. Petitioner bought no additional property.* It merely tried to liquidate the remaining unproductive assets, selling first the sawmill and, later, as it could, from time to time, various parts of the entire acreage until all was disposed of by 1935. Its action was not unlike that of a court liquidation of an insurance company holding real estate in various states and compelled to liquidate for the benefit of creditors. Such liquidation cannot be forced overnight, especially where the land is of the character involved here. We think all of the activities embraced in the findings of fact disclosed nothing more than activities incidental to an orderly liquidation; that *there is no 'warrant in the record,' no 'rational basis,' for a conclusion that petitioner held this land primarily for sale to customers in the ordinary course of its trade or business* but that rather the facts dis-

close beyond peradventure that it held the lands primarily for the purpose of cutting the timber and found itself, when the timber was cut, *in the position of having unproductive assets to liquidate which it disposed of in ordinary fashion incidentally to winding up its primary business.* Indeed, we believe that *there is no substantial evidence to support the conclusion that petitioner was engaged in business primarily for the purpose of selling land to customers in the ordinary course of its trade or business.*

"The judgment is reversed." (Italics supplied.)

Now, let us contrast that case with the present one and assume the strongest case against petitioners that can be assumed. Such a case is that they (through their company) had constructed these houses for rental purposes, were still renting them when sold, were not engaged in the buying and selling of any other real estate, but did desire to sell these houses. Again under the assumption of as dark a case for petitioners as possible, F. H. A. was pressing them to sell the houses and they were losing money. In other words, they were simply liquidating their investment in these houses just like the Three States Lumber Company was liquidating its investment in the 17,000 acres which it desired no longer to hold.

Just as the Seventh Circuit Court of Appeals held there was no rational basis for the Tax Court's conclusion in that case, so in the present one there is no rational basis for the holding by the Tax Court that petitioners held these properties primarily for

sale to customers in the *ordinary course* of their trade or business.

Of course the statement by the Tax Court (R. 32) that petitioner King had owned minority stock interests in two or three corporations engaged in subdividing and selling property is wholly immaterial, as the trade or business of a corporation is not the trade or business of a stockholder. *Dalton v. Bowers,* 287 U. S. 404; *Burnet v. Clark,* 287 U. S. 410.

As we have stated before, this decision is not one restricted merely to this particular case. These particular petitioners have further years subsequent to 1946 involved which they propose to have tried if they should lose this case. There are other taxpayers involved in the sale of houses built similarly during the war which are awaiting the decision in this case before litigating theirs. Furthermore, as pointed out above, this holding will apply to the liquidation of all kinds of investments and properties and not merely to these war housing cases, and the error of the Tax Court and the Court of Appeals should be corrected by this Honorable Court.

Conclusion.

It is respectfully submitted that this case is such as to call for the exercise by this Court of its supervisory powers, and we, therefore, respectfully pray that the petition for writ of certiorari to the United States Court of Appeals for the Fifth Circuit be granted.

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